

CHAPTER 1

UNDERWRITING THE MORTGAGE

- 1-1 WHAT FHA INSURES.** FHA insures mortgages on properties that consist of detached or semi-detached dwellings, townhouses or row houses, and individual units within FHA-approved condominium projects. Except as otherwise stated in this Handbook, FHA's single-family programs are limited to owner-occupied principal residences only. FHA will not insure mortgages on commercial enterprises, boarding houses, hotels and motels, tourist houses, private clubs, bed and breakfast establishments, and fraternity or sorority houses.

SECTION 1: OCCUPANCY STATUS

- 1-2 PRINCIPAL RESIDENCES.** A principal residence is a property that will be occupied by the borrower for the majority of the calendar year. At least one borrower must occupy the property and sign the security instrument and the mortgage note for the property to be considered owner-occupied. Our security instruments require a borrower to establish bona fide occupancy in the home as the borrower's principal residence within 60 days after signing the security instrument with continued occupancy for at least one year.

To prevent circumvention of the restrictions on FHA-insured mortgages to investors, we generally will not insure more than one mortgage for any borrower. Any person individually or jointly owning a home covered by a mortgage insured by FHA in which ownership is maintained may not purchase another principal residence with FHA mortgage insurance except under the situations described below. Properties previously acquired as investment properties are not subject to these restrictions.

We will not insure a mortgage if we conclude that the transaction was designed to use FHA mortgage insurance as a vehicle for obtaining investment properties, even if the property to be encumbered will be the only one owned using FHA mortgage insurance. We do not object to homebuyers using FHA mortgage insurance more than once if compatible with the homebuyer's needs and resources as follows:

- A. Relocations.** If the borrower is relocating and re-establishing residency in another area not within reasonable commuting distance from the current principal residence, the borrower may obtain another mortgage using FHA insured financing and is not required to sell the existing property covered by a FHA-insured mortgage. The relocation need not be employer mandated to qualify for this exception. Further, if the borrower returns to an area where he or she owns a property with an FHA-insured mortgage, it is not required that the borrower re-establish primary residency in that property in order to be eligible for another FHA insured mortgage.

- B. Increase in Family Size.** The borrower may be permitted to obtain another home with an FHA-insured mortgage if the number of legal dependents increases to the point that the present house no longer meets the family's needs. The borrower must provide satisfactory evidence of the increase in dependents and the property's failure to meet the family's needs.

The borrower also must pay down the outstanding mortgage balance on the present property to a 75 percent or lower loan-to-value (LTV) ratio. A current residential appraisal must be used to determine LTV compliance. Tax assessments, market analyses by real estate brokers, etc., are not acceptable as proof of LTV compliance.

- C. Vacating a Jointly Owned Property.** If the borrower is vacating a residence that will remain occupied by a co-borrower, the borrower is permitted to obtain another FHA-insured mortgage. Acceptable situations include instances of divorce, after which the vacating ex-spouse will purchase a new home, or one of the co-borrowers will vacate the existing property.

- D. Non-Occupying Co-Borrower.** A non-occupying co-borrower on property being purchased with an FHA-insured mortgage as a principal residence by other family members may have a joint interest in that property as well as in a principal residence of their own with a FHA-insured mortgage. (See paragraph 1-8 B for additional information).

Under no circumstances may investors use the exceptions described above to circumvent FHA's ban on loans to private investors and acquire rental properties through purportedly purchasing "principal residences." Considerations in determining the eligibility of a borrower for one of these exceptions are the length of time the previous property was owned by the borrower and the circumstances that compel the borrower to purchase another residence with an FHA-insured mortgage. *In all other cases, the purchasing borrower either must pay off the FHA-insured mortgage on the previous residence or terminate ownership of that property before acquiring another FHA-insured mortgage.*

- 1-3 SECONDARY RESIDENCES.** A secondary residence is a property the borrower occupies in addition to his or her principal residence. Secondary residences are only permitted when the appropriate Home Ownership Center (HOC) agrees that an undue hardship exists, meaning that affordable rental housing that meets the needs of the family is not available for lease in the area or within reasonable commuting distance to work, and the maximum loan amount is 85 percent of the lesser of the appraised value or sales price. Direct Endorsement (DE) lenders are not authorized to grant hardship exceptions. Any request for a hardship exception must be submitted by the lender in writing to the appropriate HOC. HOC jurisdictions are listed in Appendix I. A borrower may have only

one secondary residence at any time. All the following conditions must be met for secondary residences:

- A. The secondary residence must *not* be a vacation home or otherwise used primarily for recreational purposes; and
- B. The borrower must obtain the secondary residence because of seasonal employment, employment relocation, or other circumstances not related to recreational use of the residence; and
- C. There must be a demonstrated lack of affordable rental housing meeting the needs of the borrower in the area or within a reasonable commuting distance of the borrower's employment. Documentation to support this must include:
 - 1. A satisfactory explanation from the borrower of the need for a secondary residence and the lack of available rental housing in the area that meets the need.
 - 2. Written evidence from local real estate professionals who verify a lack of acceptable rental housing in the area.

1-4 INVESTMENT PROPERTIES. An investment property is a property that is not occupied by the borrower as a principal residence or as a secondary residence. With permission from the appropriate HOC, private investors, including nonprofit organizations not meeting the criteria described in paragraph 1-5 A, may obtain FHA-insured mortgages for the following reasons:

- A. Purchasing HUD Real Estate Owned (REO) properties. Owner occupancy is not required when the jurisdictional HOC sells the property and permits the purchaser to obtain FHA-insured financing on the investment property.
- B. Streamline refinancing without appraisals. See paragraph 1-12 for additional qualifying information.

C. Underwriting Considerations:

- 1. Individual investors who credit qualify may assume mortgages made on investment properties. This applies to the transactions described in paragraphs 1-4 A and B, as well as to investment properties purchased before the 1989 ban on investors that have been subsequently streamline refinanced.
- 2. Qualifying ratios, the treatment of projected rental income, etc., are described in Chapter 2, paragraph 2-7 M.

3. ARMs and graduated payment mortgages (GPMs) are not permitted on investment properties.
4. Except for streamline refinances in which the mortgage was originally insured in the name of a business, FHA will not insure loans made solely in the name of a business entity (such as a corporation, partnership, or sole proprietorship) or trust. One or more individuals, along with the business entity or trust, must be analyzed for creditworthiness. The individual(s) and the business entity or trust must appear on the mortgage note. The business entity, trust, or individual(s) may appear on the property deed or title. All parties appearing on the property deed or title must also appear on the security instrument (i.e., mortgage, deed of trust, security deed).

1-5 NONPROFIT ORGANIZATIONS AND STATE AND LOCAL GOVERNMENT AGENCIES.

Nonprofit organizations and state and local government agencies are permitted to purchase properties with FHA-insured mortgages, subject to the conditions listed below. These government and nonprofit organizations are eligible for the same percentage of financing available on owner-occupied principal residences. Nonprofit agencies may only obtain FHA-insured fixed rate mortgages, and only an existing FHA-insured mortgage is eligible for refinancing and may never result in equity withdrawal.

A. Nonprofit Organizations. Nonprofit organizations that intend to sell or lease the property to low- or moderate-income individuals (generally defined as income not exceeding 115 percent of the applicable median income) may obtain FHA-insured financing on rental property. The appropriate HOC is responsible for determining the nonprofit agency's eligibility to participate in FHA programs; the DE lender is responsible for determining the agency's financial capacity for repayment. Lenders also must verify that the agency is approved as a participating nonprofit agency as of the date of underwriting. Lenders can verify nonprofit approval status by visiting the HUD Website at www.hud.gov.

B. Nonprofit Approval. In order to qualify to purchase properties with FHA-insured mortgages and to obtain the same percentage of financing available to owner-occupants, HUD must approve the nonprofit agency. The nonprofit must:

1. Be of the type described in Section 501(c)(3) as exempt from taxation under Section 501(a) of the Internal Revenue Code of 1986; and
2. Have a voluntary board, and no part of the net earnings of the organization or funds from the transaction may benefit any board member, founder, contributor, or individual.

3. Have two years' experience as a provider of housing for low- and moderate- income persons.

A nonprofit agency not meeting the above requirements, including religious and charitable organizations, may only purchase properties backed by FHA mortgage insurance under the conditions described for other investors in paragraph 1-4A.

Detailed instructions on qualifying nonprofit organizations as mortgagors, including documentation requirements, are contained in Mortgagee Letter 2002-01. Questions concerning a nonprofit agency's approval should be directed to the appropriate HOC.

- C. **State and Local Government Agencies.** State and local government agencies involved in the provision of housing may obtain FHA-insured financing provided the agency meets the criteria described below. Loan applications from these entities may be processed under the DE program without prior approval from the appropriate HOC.

The agency must provide evidence from its legal counsel that the agency has the legal authority and capacity to become the borrower, that the state or local government is not in bankruptcy, and that there is no legal prohibition that would prevent the lender from obtaining a deficiency judgment (if permitted by state law for other types of borrowers) on FHA's behalf in the event of foreclosure or deed-in-lieu of foreclosure. Credit reports, financial statements, bank statements, CAIVRS/LDP/GSA checks are not required.

SECTION 2: MAXIMUM MORTGAGE AMOUNTS

- 1-6** **MAXIMUM MORTGAGE AMOUNT.** The maximum insurable mortgage is the lesser of: (1) the statutory loan limit for the area (typically a county or metropolitan statistical area (MSA)) or (2) the applicable loan-to-value (LTV) limit.

Most FHA mortgages require payment of an upfront mortgage insurance premium (UFMIP). The statutory loan amount and loan-to-value limits described in this Handbook do not include the UFMIP. All descriptions of maximum insurable mortgages throughout this Handbook, unless otherwise stated, exclude UFMIP.

- A. Statutory Loan Amount Limits.** The statutory loan amount limits vary by program and the number of family units within the dwelling, and apply to both purchases and refinances. For most programs, they may be increased when housing costs for the area support higher limits. The National Housing Act specifies the maximum loan amount for each program.

In high-cost areas, the maximum 203(b) mortgage amount (for a one-unit property) can be increased by the appropriate HOC to 95 percent of the median one-family house price in the area or 87 percent of the Federal Home Loan Mortgage Corporation (Freddie Mac) limit, whichever is less. Higher limits are available in Hawaii, Alaska, Guam, and Virgin Islands but must be justified by local house prices.

The current FHA standard and high-cost area mortgage limits can be accessed from the lender Web page on HUD's Web site at www.hud.gov or on FHA Connection at <https://entp.hud.gov/clas/>. A Mortgagee Letter is also issued each year announcing the new mortgage limits.

The standard area-wide mortgage limits and the maximum high-cost limits are indexed to the Freddie Mac conforming loan limit. Therefore, as the conventional conforming loan limits increase, the FHA loan limits also increase.

- B. Loan-to-Value Limitations.**

The mortgage insurance program, whether the loan is for the purchase of a property or for the refinance of an existing debt, the age of the property, and several additional criteria (as per paragraph 1-8) are used to determine the maximum LTV percentage available to the borrower. This LTV percentage is then applied to the lesser of the sales price or the appraised value, as described in paragraph 1-7.

1-7 MAXIMUM MORTGAGES/CASH INVESTMENT REQUIREMENTS FOR PURCHASE TRANSACTIONS. The property's sales price, subject to certain required adjustments as described in A-C below, or the appraised value, if less, is multiplied by a loan-to-value ratio. The resulting amount is the maximum mortgage that FHA will insure. The borrower must make a cash investment at least equal to the difference between the sales price and the resulting maximum mortgage amount.

Except for certain property and transaction types as described in 1-8 below, the lower of the adjusted sales price or the appraised value is multiplied by the factor shown in the chart below. The resulting amount is the maximum loan that FHA will insure *provided* that the mortgagor has made a cash investment of at least three percent of the contract sales price.

Borrower-paid closing costs may be used to meet the three percent minimum cash investment. If the borrower pays no closing costs at settlement, the loan amount must be reduced sufficiently so that the three percent minimum cash investment is met.

The maximum LTV limits shown below are functions of the property's appraised value or the adjusted sales price (whichever is less) and the State in which the property is located. (A list of states and their closing costs averages may be found in Appendix II.) The maximum LTVs for most purchase transactions are as follows:

Maximum Loan-to-Value Percentages

(Purchase Transactions Only on Proposed and Existing Construction)

States with Average Closings Costs At or Below 2.1 Percent of Sales Price

- **98.75 percent:** For properties with values/sales prices equal to or less than \$50,000.
- **97.65 percent:** For properties with values/sales prices in excess of \$50,000 up to \$125,000.
- **97.15 percent:** For properties with values/sales prices in excess of \$125,000.

States with Average Closings Costs Above 2.1 Percent of Sales Price

- **98.75 percent:** For properties with values/sales prices equal to or less than \$50,000.
- **97.75 percent:** For properties with values/sales prices in excess of \$50,000.

Our definition of closing costs does not include discount points or prepaid items and, thus, these fees and expenses cannot be used in meeting the cash investment requirements; see paragraph 1-9 A for additional information including a description of closing costs eligible for meeting the minimum cash investment requirement.

The borrower may pay for the appraisal and credit report with a credit card. However, when these fees are paid for in this manner, they may not be counted in meeting the minimum investment requirement.

Closing costs paid by the seller or lender may not be used to meet the minimum investment requirement. Subject to the limits described below, we are not concerned with the dollar amount of any particular fee charged to the seller.

- A. **Seller Contributions.** The seller (or other interested third parties such as real estate agents, builders, developers, etc., or a combination of parties) may contribute up to six percent of the property's sales price toward the buyer's actual closing costs, prepaid expenses, discount points, and other financing concessions. Contributions exceeding six percent of the sales price or exceeding the actual cost of prepaid expenses, discounts points, and other financing concessions will be treated as inducements to purchase, thereby reducing the amount of the mortgage. Closing costs normally paid by the borrower are considered contributions if paid by the seller. Inducements to purchase are described in paragraph B, below.

The six percent limitation also includes seller payment for permanent and temporary interest rate buydowns and other payment supplements, payments of mortgage interest for fixed rate mortgages and GPMs only (but not principal), mortgage payment protection insurance, and payment of UFMIP.

Fees typically paid by the seller under local or state law, or local custom, such as real estate commissions, charges for pest inspections, fees paid for trustees to release a deed of trust, etc., are not considered contributions.

The dollar limit for seller contributions is calculated by using Attachment A on the HUD-92900-PUR/HUD-92900WS. Each dollar exceeding FHA's six percent limit must be subtracted from the property's sales price before applying the appropriate LTV ratio.

- B. **Inducements to Purchase.** Certain expenses (beyond those described above) paid on behalf of the borrower, as well as other inducements to purchase, result in a dollar-for-dollar reduction to the sales price before applying the appropriate LTV ratio. These inducements include decorating allowances, repair allowances, moving costs, and other costs as determined by the appropriate HOC. We also require dollar-for-dollar

reductions to the sales price for excess rent credit (see 2-10 N), as well as for gift funds not meeting the requirements stated in Chapter 2.

Personal property items such as cars, boats, riding lawn mowers, furniture, televisions, etc., given by the seller to consummate the sale result in a reduction to the mortgage. The value of the item(s) must be deducted from the sales price and the appraised value of the property (if not already done so by the appraiser) before applying the LTV ratio. However, certain items, depending upon local custom or law, may be considered as part of the real estate transaction with no adjustment to the sales price or appraised value necessary. These items include ranges, refrigerators, dishwashers, washers, dryers, carpeting, window treatments, and other items as determined by the jurisdictional HOC. That office determines if these items affect value and are considered customary. Replacement of existing equipment or other realty items by the seller before closing, such as carpeting or air conditioners, does not require a value adjustment provided no cash allowance is given to the borrower.

In addition, if the seller or builder of the property agrees to pay any portion of the borrower's sales commission on the sale of the borrower's present residence, the amount paid by the seller or builder is an inducement to purchase and must be subtracted dollar for dollar from the sales price before the LTV ratio is applied. Similarly, a borrower not paying real estate commission on the sale of a present home constitutes a sales concession, if the real estate broker or agent is involved in both transactions and the seller of the property purchased by the borrower pays a real estate commission exceeding that typical for the area. In these situations, the amount paid by the seller above the normal real estate commission is considered an inducement to purchase and must be subtracted from the sales price of the property being purchased before applying the LTV ratio.

- C. **Additions to the Mortgage Amount.** In some cases, the maximum mortgage amount may be increased. Except for solar energy systems discussed below, an increase generally is permitted only when the appraised value exceeds the sales price. Only the amount by which the value exceeds the sales price may be added; any remaining costs become part of the borrower's settlement requirements. The following may result in an increase to the mortgage amount:

1. **Repairs and Improvements.** Repairs and improvements required by the appraiser as essential for property eligibility and to be paid by the borrower may be added to the sales price before calculating the mortgage amount. (The appraised value will reflect these requirements.) For the cost of repairs and improvements to be eligible for inclusion in the mortgage amount, the sales contract or

addendum must identify the borrower as responsible for paying for or otherwise completing the repairs or improvements.

The amount that may be added to the sales price before calculating the maximum mortgage amount is the lowest of:

- a. The amount the value of the property exceeds the sales price; or
- b. The appraiser's estimate of repairs and improvements; or
- c. The amount of the contractor's bid, if available.

Only repairs and improvements *required* by the appraiser may be included. Any repairs completed by the borrower on the property *before* the appraisal is made are not eligible for inclusion in calculating the maximum mortgage. The amount that cannot be financed into the mortgage will become part of the borrower's required cash investment.

If repairs cannot be completed before loan closing due to weather-related delays, the lender must establish an escrow account to ensure eventual completion of all required repairs. See HUD Handbook 4145.1 REV-2 for details.

2. **Energy-Related Weatherization Items.** If weatherization items are to be added to the property and paid for by the borrower, the mortgage amount may be increased by the cost of those items as described below. Weatherization items include thermostats, insulation, storm windows and doors, weather stripping and caulking, etc. These items may be added to both the sales price *and* the appraised value before determining the maximum mortgage amount. (A contractor's statement of cost of work completed or a buyer's estimate of the cost of materials must be submitted. See HUD Handbook 4150.1 REV-1 for details.) If the weatherization items cannot be completed before loan closing due to weather-related delays, the lender must establish an escrow account to ensure eventual completion of all items. See HUD Handbook 4145.1 REV-2 for details.

The amount that may be added in calculating the maximum mortgage is:

- a. \$2000 without a separate value determination; or
- b. Up to \$3500 if supported by a value determination by an approved or FHA roster appraiser or DE underwriter; or
- c. More than \$3500 subject to a value determination by an approved or FHA roster appraiser or DE underwriter and a

separate on-site inspection made by a FHA-approved fee inspector or DE staff appraiser.

3. **Solar Energy Systems.** The cost of solar energy systems may be added *directly to the mortgage amount* (before adding the UFMP) after applying the LTV ratio limits. The *statutory* mortgage limit for the area also may be exceeded by 20 percent to accommodate the cost of the system.

The amount that may be added to the mortgage is limited to the *lesser* of the solar energy system's replacement cost or its effect on the property's market value. Both active and passive solar systems are acceptable, as are wind-driven systems. See HUD Handbooks 4150.1 REV-1 and 4930.2 for details.

1-8 **TRANSACTIONS THAT AFFECT MAXIMUM MORTGAGE**

CALCULATIONS. Certain types of loan transactions affect the amount of financing available and the calculation of the maximum mortgage. These transactions include identity-of-interest, properties with non-occupying co-borrowers, three- and four-unit properties, properties for which a house will be constructed by the borrower on his or her own land or as a general contractor, payoffs of land contracts, and transactions involving properties under construction or less than a year old. Unless otherwise stated in this Handbook, the mortgage calculation procedures described in paragraph 1-6 also apply.

- A. **Identity-of-Interest Transactions.** Identity-of-interest transactions on principal residences are restricted to a maximum LTV ratio of 85 *percent*. Identity-of-interest is defined as a sales transaction between parties with family relationships or business relationships. However, maximum financing above 85 percent LTV is permissible under the following circumstances:

1. A family member purchases another family member's home as a principal residence.

If a property is sold from one family member to another and is the seller's investment property, the maximum mortgage is the lesser of either:

- a. 85 percent of the appraised value, or
- b. The appropriate LTV ratio percentage applied to the sales price, plus or minus required adjustments.

The 85 percent limit may be waived if the family member has been a tenant in the property for at least six months

immediately predating the sales contract. A lease or other written evidence must be submitted to verify occupancy.

2. An employee of a builder purchases one of the builder's new homes or models as a principal residence.
3. A current tenant purchases the property that he or she has rented for at least six months immediately predating the sales contract. (A lease or other written evidence must be submitted to verify occupancy.)
4. A corporation transfers an employee to another location, purchases that employee's home, and then sells the home to another employee.

B. Non-Occupying Borrowers. When there are two or more borrowers, but one or more will not occupy the property as a principal residence, the maximum mortgage is limited to a 75 percent LTV. However, maximum financing, as described in paragraph 1-7, is available for borrowers related by blood, marriage or law (spouses, parent-child, siblings, stepchildren, aunts-uncles/nieces-nephews, etc.), or for unrelated individuals that can document evidence of a family-type, longstanding, and substantial relationship *not arising out of the loan transaction*. All borrowers, regardless of occupancy status, must sign the security instrument and mortgage note. If a parent is selling to a child, the parent cannot be the co-borrower with the child on the new mortgage unless the loan-to-value is 75 percent or less.

To reduce risk exposure, mortgages with non-occupying co-borrowers are limited to one-unit properties if the LTV will exceed 75 percent. While we do not object to legitimate transactions in which non-occupant borrowers assist in the financing of the property—such as when parents help their children buy a first home—this arrangement may not be used by non-occupant borrowers to develop a portfolio of rental properties. The degree of financial contribution by the non-occupant borrower, and the number of properties similarly owned, may indicate that an investor loan has become the practical reality and that, in effect, family members are acting as "strawbuyers." FHA does not impose additional underwriting criteria on such transactions, such as specific qualifying ratios the occupying-borrower must meet individually. Lenders must judge each transaction on its merits.

C. Three- and Four-Unit Properties. Regardless of occupancy status, the property must be self-sufficient (i.e., the maximum mortgage is limited so that the ratio of the monthly mortgage payment, divided by the monthly net rental income, does not exceed 100 percent). The mortgage

calculations described below are in addition to the calculations detailed in paragraphs 1-6 and 1-7.

1. The monthly payment is the principal, interest, taxes, and insurance (PITI), including mortgage insurance, plus any homeowners' association dues, computed at the note rate (no consideration for buydowns may be given).
2. Net rental income is the appraiser's estimate of fair market rent from *all units*, including the unit chosen by the borrower for occupancy, less the appraiser's estimate for vacancies or the vacancy factor used by the jurisdictional HOC, whichever is greater.

This calculation is used only to determine the maximum loan amount. Borrowers must still qualify for the mortgage based on income, credit, cash to close, and the projected rents received from the remaining units. The projected rent may only be considered as gross income for qualifying purposes; it may not be used to offset the monthly mortgage payment.

3. The borrower must have reserves equivalent to three months' PITI after closing on purchase transactions. Reserves cannot be derived from a gift.

D. Building on Own Land. If the borrower acts as a general contractor, and builds a house on land that the borrower already owns, or acquires land separately, maximum financing is available if the borrower receives no cash from the settlement. The appropriate LTV limits are applied to the *lesser of*:

1. The appraised value; or
2. The documented acquisition cost of the property, which includes:
 - (a) the builder's price, or the sum of all subcontractor bids, materials, etc.;
 - (b) cost of the land (if the land has been owned more than six months or was received as an acceptable gift, the *value* of the land may be used instead of its cost);
 - (c) interest and other costs associated with any construction loan obtained by the borrower to fund construction of the property;
 - (d) the closing costs to be paid by the borrower; and
 - (e) reasonable discount points.

Equity in the land (value or cost, as appropriate, minus the amount owed) may be used for the borrower's entire cash investment. However, if the borrower receives more than \$250 cash at closing, the loan is limited to 85 percent of the sum of the appraised value and allowable closing costs. Replenishment of the borrower's own cash expended during construction

is not considered as "cash back," provided the borrower can substantiate with cancelled checks and paid receipts all out-of-pocket funds used for construction.

- E. Paying Off Land Contracts.** If the borrower will use the loan to complete payment on a land contract, contract for deed, or other similar type financing arrangement in which the borrower does not have title to the property, the new mortgage may be processed as either a purchase or a refinance transaction with maximum FHA-insured financing *if the borrower receives no cash at closing*. If all loan proceeds are used to pay the outstanding balance on the land contract and eligible repairs, renovations, etc., the appropriate LTV ratio is applied to the *lesser of*:

1. The appraised value; or
2. The total cost to acquire the property (the original purchase price, plus any documented costs the purchaser incurs for rehabilitation, repairs, renovation, or weatherization), plus allowable closing costs and, if treated as a refinance, reasonable discount points.

Equity in the property (original sales price minus the amount owed) may be used for the borrower's entire cash investment. However, *if the borrower receives more than \$250 cash at closing*, the loan is limited to 85 percent of the sum of the appraised value and allowable closing costs. Replenishment of the borrower's own cash expended for repairs, improvements, renovation, etc., is not considered as "cash back," provided the borrower can substantiate with cancelled checks and paid receipts all out-of-pocket funds spent for those purposes.

F. Properties Under Construction or Existing Construction Less than One Year Old

Properties not meeting the criteria shown below are considered as under construction or existing construction-less than one year old and are limited to 90 percent financing, i.e., 90 percent of the lesser of the appraiser's estimate of value or sales price, plus or minus the adjustments required by paragraph 1-7, A-C. For a property to be eligible for greater than 90 percent financing, whether or not it has been previously occupied, it must meet one of the criteria described below. Otherwise, the property is classified as "under construction" or "less than one year old" and is limited to 90 percent financing.

1. Construction was completed more than one year preceding the borrower's signature on the Addendum to Uniform Residential Loan Application (form HUD-92900-A, page 2); or
2. The dwelling's site plans and materials were approved by the Department of Veterans Affairs (VA), an eligible DE underwriter,

- or a builder under FHA's builder certification procedures, (see HUD Handbook 4145.1 REV-2) before construction began; or
3. The local jurisdiction has issued both a building permit (prior to construction) and a Certificate of Occupancy or equivalent.
(NOTE: This paragraph does not apply to condominiums or manufactured housing because of the special circumstances regarding their approval.); or
 4. The dwelling is covered by a builder's ten-year insured warranty plan that is acceptable to HUD; or
 5. The dwelling will be moved to a new location and the property is eligible for an insured mortgage at the new location by one of the methods described in 2 above.

AVAILABLE FOR INFORMATIONAL PURPOSES ONLY

SECTION 3: SETTLEMENT REQUIREMENTS

- 1-9 SETTLEMENT REQUIREMENTS.** For each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. In addition to the minimum cash investment described in paragraph 1-7, additional borrower expenses, including those described in A-I below, must be included in the total amount of cash the borrower must provide at mortgage settlement. The difference between the amount of the FHA-insured mortgage, excluding any UFMIP, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.
- A. Closing Costs.** These include those FHA-approved non-recurring costs associated with the mortgage transaction, including the appraisal fee, any inspection fees, the actual cost of credit reports, the loan origination fee, settlement fee, deposit verification fees, home inspection service fees up to \$300, the cost of title examination and title insurance, document preparation fees (if performed by a third-party not controlled by the lender), property survey fees, attorney's fees, recording fees, transfer stamps, and taxes, as well as test and certification fees, such as flood-zone determination fees, water tests, and other costs as determined by the appropriate HOC.
- B. Prepaid Items.** Prepaid items are collected at closing to cover accrued and unaccrued hazard insurance and mortgage insurance premiums, taxes and per diem interest, and include other similar fees and charges. The lender must use a minimum of 15 days of per diem interest in its estimate of prepaid items.
- To reduce the burden on borrowers whose loans were scheduled to close at the end of the month but did not due to unforeseen circumstances, lenders and borrowers may agree to credit the per diem interest to the borrower and have the mortgage payments begin the first of the succeeding month. However, the dollar amount of the cash credit is not to be used to reduce the minimum cash investment.
- C. Discount Points.** Discount points that are being paid by the borrower become part of the total cash investment but are not eligible for meeting the minimum cash investment requirement.
- D. Non-Realty (Chattel) or Personal Property.** Non-realty or personal property items that the borrower agrees to pay for separately, including the amount subtracted from the sales price in determining the maximum mortgage, are included in the total cash requirements for the loan.

- E. Closing Costs Not Eligible for Meeting the Cash Investment Requirement.** Certain closing costs, such as commitment fees for guaranteeing the rate or points, and fees such as any ineligible real estate broker fees or any portion, or any such allowable fee not previously included in meeting the investment requirement are included in calculating the total cash needed to close the mortgage.
- F. UFMIPs.** Any UFMIP amounts paid in cash are added to the total cash settlement requirements. The UFMIP must be entirely financed into the mortgage (except for any amount less than \$1) or paid entirely in cash and all mortgage amounts must be rounded down to a multiple of \$1.
- G. Repairs and Improvements.** Repairs and improvements (or any portion) to be paid by the borrower that cannot be financed into the mortgage are part of the borrower's total cash requirements.
- H. Real Estate Broker Fees.** If the borrower is represented by a real estate buyer-broker and must pay a fee directly to the broker, that expense must be included in the total of the borrower's settlement requirements and appear on the HUD-1 Settlement Statement.

If the seller pays the buyer-broker fee as part of the sales commission, this is not to be considered an inducement to purchase or part of the 6 percent seller contributions limitation, *provided* that the seller is paying only the normal sales commission typical of that market. The lender must obtain a copy of the original listing agreement and compare it with the HUD-1 Settlement Statement to determine if the seller paid a buyer-broker fee in addition to the normal sales commission for that market. If the seller paid an additional commission for the buyer-broker fee, then this is considered an inducement to purchase.

- I. Mortgage Broker Fees.** If the borrower must pay a fee directly to a mortgage broker, that expense must be included in the total of the borrower's cash settlement requirements and appear on the HUD-1 Settlement Statement. (This requirement applies to instances in which the borrower independently engages a mortgage broker to seek financing and pays the broker directly. The payment may not come from the lending institution.)
- J. Premium Pricing on FHA Insured Mortgages.** Lenders may pay the borrower's allowable closing costs and/or prepaid items by "premium pricing". Closing costs paid in this manner need not be included as part of the 6 percent seller contribution limit. The funds derived from a premium priced mortgage:

1. May never be used to pay any portion of the borrower's downpayment.
2. Must be disclosed on the Good-Faith Estimate (GFE) and the HUD-1 Settlement Statement. The GFE and HUD-1 must include an itemized statement indicating which items are being paid on the borrower's behalf; disclosing only a lump sum is not acceptable. Also, the amount paid on the borrower's behalf for each item may not exceed the allowable fee permitted by the jurisdictional HOC.
2. Must be used to reduce the principal balance if the premium pricing agreement establishes a specific dollar amount for closing costs and prepaid expenses with any remaining funds, in excess of actual costs, reverting to the borrower.
3. May not be used for payment of debts, collection accounts, escrow shortages or missed mortgage payments, or judgments.

K. Yield Spread Premiums. Yield spread premiums (YSP) are not part of the cash required to close but must be disclosed to borrowers on the Good Faith Estimate (GFE) and HUD-1 Settlement Statement in accordance with the Real Estate Settlement Procedures Act (RESPA) requirements.

SECTION 4: REFINANCE TRANSACTIONS

1-10 REFINANCING. A refinance transaction involves repaying an existing real estate debt from the proceeds of a new mortgage that has the same borrower(s) and the same property. As long as the borrower has legal title (even though not originally on the loan), the borrower is eligible to refinance the loan.

The following must be considered when processing a refinance transaction:

- A. Maximum Percentage of Financing:** The maximum percentage of financing is governed by the occupancy status of the property, the use of the loan proceeds, and how and when the property was purchased. FHA will insure several different types of refinance transactions including streamline refinances of existing FHA-insured mortgages made with and without appraisals, "no cash-out" refinances of conventional and FHA-insured mortgages where all proceeds are used to pay existing liens and costs associated with the transaction, and "cash-out" refinances.
- B. Maximum Term.** The maximum term of any refinance with an appraisal is 30 years. A streamline refinance (see Section 1-12) without an appraisal is limited to the remaining term of the existing mortgage plus 12 years (not to exceed 30 years).
- C. Re-Using an Appraisal.** FHA appraisals on existing properties remain valid for six months. However, they cannot be re-used during this period once the mortgage, for which the appraisal was ordered, has closed. An appraisal used for the purchase of a property cannot be used again for a subsequent refinance, even if six months have not passed. A new appraisal is required for each refinance transaction requiring an appraisal.
- D. Refinance Authorization.** A lender must obtain a Refinance Authorization Number from the FHA Connection or functional equivalent for all FHA-to-FHA refinances.
- E. "Skipped" Payments Not Acceptable.** Lenders are not permitted to allow borrowers to "skip" payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments "skipped" by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

1-11 MORTGAGE AMOUNTS ON REFINANCES.

A. **"No Cash-Out" Refinances with Appraisals (Credit Qualifying).** The maximum mortgage is the *lower* of the loan-to-value or the existing debt calculation described below, and may never exceed the statutory limit except by the amount of any new upfront MIP:

1. **LTV Ratio Applied to Appraised Value:** Multiply the appraised value of the property by the appropriate factor, as shown in the chart below, for the property's value and the state where it is located. (A list of states and their closing costs averages may be found in Appendix II.) Any appraisal requirements, including repairs, must be complied with before the mortgage is eligible for insurance endorsement.

Maximum Loan-to-Value Percentages

States with Average Closings Costs At or Below 2.1 Percent of Sales Price

- **98.75 percent:** For properties with appraised values equal to or less than \$50,000.
- **97.65 percent:** For properties with appraised values in excess of \$50,000 up to \$125,000
- **97.15 percent:** For properties with appraised values in excess of \$125,000.

States with Average Closings Costs Above 2.1 Percent of Sales Price

- **98.75 percent:** For properties with appraised values equal to or less than \$50,000.
- **97.75 percent:** For properties with appraised values in excess of \$50,000.

2. **Existing Debt.** Add together the amount of the existing first lien, any purchase money second mortgage, any junior liens over 12 months old, closing costs, prepaid expenses, borrower paid repairs required by the appraisal, discount points, and other fees as determined acceptable by the appropriate HOC and then subtract any refund of UFMIP. (If any portion of the funds of an equity line of credit in excess of \$1000 was advanced within the past twelve months and was for purposes other than repairs and rehabilitation of the property, the line of credit is *not* eligible for inclusion in the new mortgage.)

The amount of the existing first mortgage may include the interest charged by the servicing lender when the payoff will not likely be received on the first day of the month (as is typically assessed on FHA-insured mortgages). The amount also may include any prepayment penalties assessed on a conventional mortgage or FHA Title I loan. The amount of the existing first mortgage may not include delinquent interest, late charges, or escrow shortages. Prepaid expenses may include the per diem interest to the end of the month on the new loan, hazard insurance premium deposits, mortgage insurance premium, and any real estate tax deposits needed to establish the escrow account.

Subordinate liens, including credit lines, regardless of when taken, may remain outstanding, provided the FHA-insured mortgage meets our eligibility criteria for mortgages with secondary financing as described in Section 5 of this chapter.

If the purpose of the new loan is to refinance an existing mortgage to buy out an ex-spouse's or other co-borrower's equity, the specified equity to be paid is considered property-related indebtedness and is eligible for inclusion in calculating the new mortgage. The divorce decree, settlement agreement, or other bona fide equity agreement must be provided to document the equity awarded to the ex-spouse or co-borrower.

If the property was acquired less than one year before the loan application and is not already FHA-insured, in addition to the calculations described above, the original sales price of the property also must be considered in determining the maximum mortgage. With conclusive documentation, expenditures for repairs and rehabilitation incurred after the purchase of the property may be added to the original sales price in calculating the mortgage amount.

B. "Cash-Out" Refinances. "Cash-out" refinances are only permitted on owner-occupied principal residences and are limited to a combined LTV (FHA-insured first and any subordinate liens) of 85 percent of the appraised value, provided the property has been owned by the borrower for at least one year. If the property was purchased less than one year preceding the loan application, the mortgage amount must be calculated using the lesser of the appraised value or the original sales price of the property multiplied by 85 percent. Properties owned free and clear may be refinanced as cash-out transactions.

“Cash-out” refinances for debt consolidation represent considerable risk, especially if the borrowers have not had an attendant increase in income. Such transactions must be carefully evaluated.

- 1-12 STREAMLINE REFINANCES.** Streamline refinances are designed to lower the monthly principal and interest payments on a current FHA-insured mortgage and must involve no cash back to the borrower, except for minor adjustments at closing not to exceed \$250. Streamline refinances can be made with or without an appraisal. On streamline refinances with an appraisal, Form HUD 92564-VC is required, but the Homebuyer Summary is not required. FHA does not require repairs to be completed (except for lead-based paint repairs) on streamline refinances with appraisals; however, the lender may require completion of repairs as a condition of the loan.

HUD's Credit Alert Interactive Voice Response System (CAIVRS) need not be checked, but HUD's Limited Denial of Participation (LDP) and General Services Administration (GSA) exclusion lists are still required checks for all borrowers. FHA does not require a credit report (except for the credit-qualifying streamline refinances described below) or a termite inspection on this type of loan, but the lender may require either one or both as part of its credit policy.

Lenders may use an abbreviated version of the Uniform Residential Loan Application (URLA) that omits sections IV, V, VI, and a-k of VIII, provided all other required information is captured. Furthermore, while the lender must assure itself that it is in compliance with Equal Credit Opportunity Act (ECOA) and all other regulations, the loan application need not be signed by the borrower(s) until loan closing.

Streamline refinance processing and underwriting instructions are described below. The mortgage amount limits may never exceed the statutory limits except by the amount of any new upfront MIP.

- A. Streamline Refinances WITHOUT an Appraisal.** The maximum insurable mortgage is the *lower* of the two calculations shown below:

1. Original Loan Amount: The original principal balance on the mortgage (which will include any upfront mortgage insurance premium) plus the new upfront premium that will be charged on the refinance, or
2. Existing Debt: Add the sum of the existing FHA insured first lien, closing costs, reasonable discount points and the prepaid expenses necessary to establish the escrow account, and subtract any refund of upfront mortgage insurance premiums (UFMIP). The existing first lien may include the interest charged by the servicing lender when the payoff is not received on the first day of the month as is

typically assessed on FHA mortgages, but may not include delinquent interest, late charges or escrow shortages.

This mortgage calculation process applies only to owner-occupied properties. Investment properties, even if originally acquired as principal residences by the current borrowers, may only be refinanced for the outstanding principal balance. The term of the mortgage is the lesser of 30 years or the remaining term of the mortgage plus 12 years.

Streamline refinances by investors or for secondary residences may only be made without an appraisal and may be made solely in the business entity's name if previously insured in the business entity's name. The new security instruments will contain FHA's standard provision permitting acceleration of the mortgage upon assumption by an investor or as a secondary residence; however, FHA does not intend to authorize the lender to exercise the acceleration provision if the investor assumptor is found to be creditworthy.

Although a property purchased as a principal residence, under certain circumstances as described in the security instruments, may be rented, a streamline refinance without an appraisal does not "convert" the mortgage to one eligible for assumption by an investor.

B. Streamline Refinance WITH an Appraisal (No Credit Qualifying).

The maximum insurable mortgage is the *lower* of the appropriate loan-to-value ratio applied to the appraiser's estimate of value or the sum of the existing indebtedness and related closing costs and prepaid expenses for the refinance; both are described below.

1. LTV Ratio Applied to Appraised Value: Multiply the appraised value of the property by the appropriate factor as shown in the chart below for the property's value and the State where it the property is located. (A list of states and their closing costs averages may be found in Appendix II.)

Maximum Loan-to-Value Percentages

States with Average Closings Costs At or Below 2.1 Percent of Sales Price

- **98.75 percent:** For properties with appraised values equal to or less than \$50,000.
- **97.65 percent:** For properties with appraised values in excess of \$50,000 up to \$125,000
- **97.15 percent:** For properties with appraised values in excess of \$125,000.

States with Average Closings Costs Above 2.1 Percent of Sales Price

- **98.75 percent:** For properties with appraised values equal to or less than \$50,000.
- **97.75 percent:** For properties with appraised values in excess of \$50,000.

2. **Existing Debt:** Add the sum of the existing FHA insured first lien, closing costs, reasonable discount points and the prepaid expenses necessary to establish the escrow account, and subtract any refund of upfront mortgage insurance premiums (UFMIP) as described below. The existing first lien may include the interest charged by the servicing lender when the payoff is not received on the first day of the month as is typically assessed on FHA mortgages, but may not include delinquent interest, late charges or escrow shortages.

- C. **"Credit-Qualifying" Streamline Refinances.** "Credit-qualifying" streamline refinances contain all the normal features of a streamline refinance, but provide a level of assurance of continued performance on the mortgage. The lender must provide evidence that the remaining borrowers have an acceptable credit history and ability to make payments.

The following must be considered when processing a credit-qualifying transaction:

1. **Mortgage Amount.** The maximum loan amount is the same as in A (without appraisal) or B (with appraisal) above, as appropriate.
2. **Credit Documentation/Qualifying.** The lender must provide a verification of income, a credit report, compute the debt-to-income ratios and determine that the borrower will continue to make mortgage payments.
3. **Purposes.** Credit-qualifying streamline refinances may be used for the following:

- a. When a change in the mortgage term will result in an increase in the mortgage payment. (This is only permitted for owner-occupied principal residences, secondary residences meeting the requirements of paragraph 1-3, and those investment properties purchased by governmental agencies and eligible nonprofit organizations described in paragraph 1-5.)
- b. When deletion of a borrower or borrowers will trigger the due-on-sale clause.
- c. Following an assumption of a mortgage that does not contain restrictions (e.g., due-on-sale clause) limiting assumptions only to creditworthy borrowers *and* the assumption occurred less than six months previously.
- d. Following an assumption of a mortgage in which the transferability restriction (i.e., due-on-sale clause) was not triggered, such as in a property transfer resulting from a divorce decree or by devise or descent *and* the assumption occurred less than six months previously.

D. Additional Information on Streamline Refinances.

1. **Appraisal, Termite Inspection, and Credit Report Fees.** We do not require an appraisal, termite inspection, or credit report on streamline refinances (except credit qualifying streamline refinances). However, the associated fees may be paid by the borrower out-of-pocket (i.e., not financed) if law, banking regulations, or its secondary market investors require the lender to obtain these services on a streamline refinance made without a FHA appraisal.
2. **Cash-to-Close.** Borrowers are not required to provide evidence of cash-to-close.
3. **Withdrawn Condominium Approvals.** If approval of a condominium project has been withdrawn, FHA will insure only streamline refinances *without* appraisals for that condominium project.
4. **Underwriting.** Mortgage credit underwriting is not required except for credit qualifying streamline refinance. The loan application and form HUD 92900-WS must be submitted; however, the sections regarding income, assets, and debts and

obligations need not be completed (unless the borrowers are credit qualified).

5. **Shortening the Term of Mortgage.** A mortgage on a principal residence may be refinanced to a shorter-term mortgage, provided the new monthly principal and interest payment increases no more than \$50. (The \$50 latitude is not available for mortgages on investment properties or secondary residences, unless the borrower qualifies under the provisions described in paragraphs 1-3 and 1-4.) Since streamline refinances are designed to reduce the borrower's *principal and interest payments* on a current FHA-insured mortgage, that portion of the borrower's payment for escrowed items need not be considered.
6. **Delinquent Mortgages.** Delinquent mortgages are not eligible for streamline refinancing until the loan is brought current. However, if the mortgage is delinquent by no more than two monthly payments, the refinancing lender may pay the borrower's mortgage to bring the payments current provided no obligation is placed on the borrower to repay the funds used to bring the mortgage current.
7. **"No-Cost" Refinances.** "No-cost" refinances, in which the lender charges a premium interest rate to defray the borrower's closing costs and/or prepaid items, are permitted. The lender may also offer an interest-free advance of amounts equal to the present escrow balances on the existing mortgage to establish a new escrow account.
8. **Holding Period before Eligibility.** A borrower who assumed or took title subject to an FHA-insured mortgage, without being credit qualified and with the previous mortgagors receiving a release of liability, must have owned the property for at least six months before being eligible for the streamline refinance program without credit qualifying. This rule applies to mortgages that do not contain restrictions limiting the assumption only to creditworthy assumptors. Typically those mortgages were made prior to December 1989.
9. **Adding or Deleting Individuals on Title.** Individuals may be *added* to the title on a streamline refinance without credit worthiness review and without triggering due-on-sale clauses. Individuals can be deleted from the title on a streamline refinance only under the circumstances described in paragraph 1-12 C, above or:

- a. When an assumption of a mortgage not containing a due-on-sale clause occurred more than six months previously and the assumptor can document that he or she has made the mortgage payments during this interim period; or
- b. Following an assumption of a mortgage in which the transferability restriction (due-on-sale clause) was not triggered, such as in a property transfer resulting from a divorce decree or by devise or descent, and the assumption or quit-claim of interest occurred more than six months previously and the remaining owner-occupant can demonstrate that he or she has made the mortgage payments during this time.
10. **Seven-Unit Exemptions.** An eligible investor that has a financial interest in more than seven rental units, as described in 24 CFR 203.42, may only refinance *without* appraisals.
11. **Subordinate Financing.** Subordinate financing may remain in place, regardless of the total indebtedness against the property on streamline refinances, with or without appraisals. The borrower is not required to satisfy any outstanding subordinate liens, as long as they will clearly be subordinate to the new FHA-insured refinance mortgage.
12. **Proceeding as if No Appraisal was Completed.** If the appraised value is such that the borrower would be better advised to proceed as if no appraisal had been made, the appraisal may be ignored and not used. A notation of this decision must be made in the "remarks" section of form HUD-92900-WS.
13. **Geographic Areas.** Lenders may solicit and process streamline refinances applications from any area of the country, provided the lender is approved for DE by at least one HOC.
14. **ARM to ARM.** An ARM may be refinanced to another ARM, *provided* that an immediate payment reduction occurs and that the maximum interest rate of the new mortgage does not exceed the maximum interest rate of the old mortgage being refinanced. These refinances may be transacted with or without an appraisal.
15. **ARM to Fixed Rate.** An ARM may be refinanced to a fixed rate mortgage, with or without an appraisal, *provided* the interest rate on the new fixed-rate mortgage will be no greater than 2 percentage points above the current rate of the ARM. In addition, all mortgage payments must have been made within the month due

for the past 12 months or the period the mortgage has been in force, if shorter. If the new fixed rate mortgage will be at a rate lower than the existing rate of the ARM thus reducing the homeowner's monthly mortgage payment, the "within the month due," (i.e., not more than 30 days late), rule is not applicable.

16. **Fixed-Rate to ARM.** Fixed-rate mortgages may be refinanced to a one-year ARM, with or without an appraisal, provided the interest rate of the new mortgage is at least 2 percentage points below the interest rate of the current mortgage.

An ARM may be used for refinancing only on principal residences.

17. **Graduated Payment Mortgages (GPM) to Fixed-Rate.** Section 245 GPMs may be refinanced, with or without an appraisal, to a fixed-rate mortgage *provided* the new mortgage payment will not exceed the current mortgage payment. (If the streamline refinance is completed without an appraisal, the new mortgage amount may exceed the statutory limit by the accrued negative amortization and the new UFMIP.)

18. **GPM to ARM.** A GPM may be refinanced to an ARM, *provided* the note rate results in a reduction to the current principal and interest payments. (If the streamline refinance is completed without an appraisal, the new mortgage amount may exceed the statutory limit by the accrued negative amortization and the new UFMIP.)

19. **Section 203(k) to Section 203(b).** Section 203(k) Rehabilitation mortgages may be refinanced into a Section 203(b) mortgage after all work is complete. The rehabilitation work is considered complete by a fully executed certificate of completion, the rehabilitation escrow account has been closed with a final release, and the lender has entered the required close out information into the FHA Connection or its functional equivalent. The new mortgage will be subject to the appropriate insurance premium applicable to a new Section 203(b) mortgage.

20. **Section 235 to Section 203(b).** Lenders may refinance Section 235 mortgages to Section 203(b) mortgages using the streamline underwriting procedures described in paragraph 1-12. Any overpaid subsidy that has been paid by the lender to HUD and is part of the borrowers' mortgage account can be included in the Section 203(b) mortgage amount, provided the mortgage amount does not exceed the maximum mortgage permitted under paragraphs 1-12 A or 1-12 B as appropriate.

Furthermore, if HUD has a junior lien that was part of the original Section 235 financing, HUD will subordinate the junior lien to the Section 203(b) mortgage that refinances the Section 235 mortgage.

AVAILABLE FOR INFORMATIONAL PURPOSES ONLY

SECTION 5: SECONDARY FINANCING

1-13 SECONDARY FINANCING.

Any financing (other than the FHA-insured first mortgage) that creates a lien against the property is considered secondary financing and not a gift, even if it is a “soft” or “silent” second (i.e., has no monthly repayment provisions) or has other features forgiving the debt.

Documentation from the provider of the secondary financing must show the amount of funds provided to the borrower in each transaction and copies of the loan instruments are to be included in the endorsement binder. Costs incurred for participating in a downpayment assistance secondary financing program may only be included in the amount of the second lien. FHA reserves the right to reject any secondary financing that does not serve the needs of the intended borrower or where it believes the costs to the participants outweigh the benefits derived by the homebuyer. Permissible secondary financing arrangements include:

- A. Government Agencies.** Federal, state, and local government agencies, as well as nonprofit agencies considered instrumentalities of government (see B, below), may provide secondary financing *for the borrower's entire cash investment*. The second lien itself must be made or held by the eligible governmental body or instrumentality. Neither governmental units nor their established nonprofit instrumentalities may use “agents,” including other nonprofits or for-profit enterprises to make the second lien regardless of the source of those funds. In other words, even if the funds used for the secondary financing were *derived* from an acceptable source such as HUD HOME funds or from a unit of government or the eligible nonprofit instrumentality, the subordinate lien must be in the name of the eligible entity, i.e., the state, county, city or eligible nonprofit instrumentality must be the lien holder. This authority cannot be delegated to another party that is not itself permitted to provide this level of secondary financing. These other entities, however, may be used to *service* the subordinate lien if regularly scheduled payments are to be made by the mortgagor. Loans secured by secondary mortgages are subject to the conditions described below.

1. The FHA-insured first mortgage, when combined with any second mortgage or other junior liens from government agencies may not result in cash back to the borrower. The sum of all liens cannot exceed 100 percent of the cost to acquire the property. The cost to acquire is the sales price plus allowable borrower-paid closing costs, discount points, repair and rehabilitation expenses, and prepaid expenses. The cost to acquire may exceed the appraised value of the property under these types of government assistance programs. The FHA insured first mortgage cannot exceed the

FHA statutory limit for the area where the property is located. The combined indebtedness, however, may exceed the FHA statutory limit.

2. The required monthly payment under both the insured mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, cannot exceed the borrower's reasonable ability to pay.
3. The source, amount, and repayment terms must be disclosed in the mortgage application, and the borrower must acknowledge that he or she understands and agrees to the terms.

B. Nonprofit Agencies. Nonprofit agencies that meet the criteria described in paragraph 1-5 B *and* are considered instrumentalities of government may provide secondary financing under the terms outlined in A, above. The appropriate HOC is responsible for approving the nonprofit agency, as well as determining if it can be considered an instrumentality of government. To obtain this status the nonprofit must be an entity “established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated by law (statute or court opinion).” FHA also requires that the unit of government that *established* the nonprofit also must either exercise organizational control, operational control, or financial control of the nonprofit in its entirety or, at minimum, the specific homebuyer assistance program that is using FHA’s credit enhancement. The HOCs review applications from nonprofits that purport to be instrumentalities of government and make approval decisions based on information submitted by the nonprofit.

Nonprofit agencies *not* considered instrumentalities of government that otherwise meet the criteria described in paragraph 1-5 B may provide secondary financing under the same conditions as described in A, above, *provided* the borrower makes a cash investment of at least 3 percent of the acquisition cost and the combined amount of the first and second mortgages do not exceed the statutory loan limit for the area where the property is located. The jurisdictional HOC is responsible for approving the nonprofit agency.

C. Other Organizations and Private Individuals. Other organizations and private individuals may provide secondary financing under the following conditions:

1. The combined amount of the first and second mortgages do *not* exceed the applicable LTV ratio and the maximum mortgage limit for the area.

2. The repayment terms of the second mortgage must not provide for a balloon payment before ten years (or other such term acceptable to FHA), unless the property is sold or refinanced, and must permit prepayment by the borrower, without penalty, after giving the lender 30 days advance notice.
3. The required monthly payment under both the insured mortgage and the second mortgage or lien, plus other housing expenses and all recurring charges, cannot exceed the borrower's reasonable ability to pay. Any periodic payments due on the second mortgage are due monthly and are essentially the same in dollar amount.

D. Borrowers 60 Years of Age or Older. Borrowers 60 years of age or older may borrow the required cash investment for purchasing a principal residence, provided:

1. The donor or lender is a relative of the borrower, a close friend with clearly defined interest in the borrower, the borrower's employer, or an institution established for humanitarian or welfare purposes.
2. The donor or lender's interest is not solely in the sale of the property, such as a builder or seller, or any person or organization associated with builders or sellers.
3. The principal amount of the insured mortgage loan, plus the note or other evidence of indebtedness in connection with the property, may not exceed 100 percent of the value, plus prepaid expenses.
4. The note or other evidence of indebtedness may not bear an interest rate exceeding the interest rate of the insured mortgage.

E. Family Member Lending. Family members (defined below) may help with the costs of acquiring a home in the form of a gift or a loan. All such gifts must also meet the requirements of paragraph 2-10(C). FHA permits family member to lend on a secured or unsecured basis, up to 100 percent of the homebuyer's required cash investment. This lending may include the downpayment, closing costs, prepaid expenses and discount points. If the money lent by the family member is secured against the subject property, whether borrowed from an acceptable source or from the family member's own savings, only the family member provider(s) may be the note holder. FHA will not approve any form of securitization of the note that results in any entity other than the family member being the note holder, whether at loan settlement or at any time during the mortgage life cycle.

Further, if the funds that are lent by the family member are borrowed from an acceptable source, the homebuyer may not be a co-obligor on that note (e.g., the son and daughter-in-law may not be co-obligors on the note used to secure money borrowed by the parents that in turn was lent for the down payment).

The following financing terms and conditions also apply:

1. The maximum insurable mortgage is not affected by gifts or loans from family members.
2. The combined amount of financing may not exceed 100 percent of the lesser of the property's value or sales price, plus normal closing costs, prepaid expenses, and discount points. While the family member may lend 100 percent of the cash investment requirements, cash back to the homebuyer (beyond refund of any earnest money deposit) at closing is not acceptable.
3. If periodic payments of the secondary financing are required, the combined payments may not exceed the borrower's reasonable ability to pay. The secondary financing payments are to be included in the total debt-payment-to-income ratio (i.e., the "back-end" ratio) for qualifying purposes.
4. The second lien may not provide for a balloon payment within five years from the date of execution.
5. If the family member providing the secondary financing borrows those funds, the source may not be any entity with an identity-of-interest in the sale of the property, including the seller, builder, loan officer, real estate agent, etc. Mortgage companies that have retail banking affiliates may have that entity make a loan to the family member, providing the secondary financing for the home purchase. However, the lending institution may not make such financing available under terms and conditions more favorable than to other borrowers (i.e., there may not be any special considerations provided in connection between making the mortgage and lending funds to family members to be used as secondary financing for the purchase of the home).
6. An executed copy of the document outlining the terms of the secondary financing must be maintained in the lender's file. An executed copy of this agreement also must be provided in the endorsement binder.

For the purposes of this paragraph, a “family member” is defined as a child, parent, or grandparent of the borrower or borrower’s spouse. Included in this definition are legally adopted sons or daughters (and a child who is a member of an individual's household, if placed with such individual by an authorized agency for legal adoption by that individual), and foster children. The term "child" means a son, stepson, daughter, or stepdaughter.

AVAILABLE FOR INFORMATIONAL PURPOSES ONLY